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The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC #03011-88
31 August 1988MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central IntelligenceFROM: Fritz W. Ermarth
Chairman

SUBJECT: Sense of the Community Memorandum on Panama Sanctions

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1. Action: That you approve distribution of the attached Sense of the Community Memorandum assessing the current impact of US economic sanctions on Panama.

2. Deane Hoffmann, NIO/ECON, has recommended the distribution of an update on the impact of sanctions. A more broad-gauged NIE on political prospects for Panama is in the works but won't be completed until later in the fall.

3. The attached Sense of the Community Memorandum was drafted by [] the Assistant NIO/ECON, and coordinated by CIA, DIA, NSA, Army, Navy, Treasury []. Knowing him to be concerned about the political and policy impact of a largely negative assessment, I checked personally with Mort Abramowitz as to his view of this Memorandum. Mort reviewed it personally, found it sound and professional, and recommends its distribution.

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4. I am seeking your permission to go ahead with distribution because of the political sensitivity of the subject. I think this Memorandum soberly assesses the situation and meets our obligation to keep a candid assessment before the policymaker without being gratuitously carping about problems of which all are aware. The broader political NIE on Panama should be ready by the time the USG is again in a position to review policy toward that country.

5. Recommendation: That you approve NIC distribution of the attached Sense of the Community Memorandum.


Fritz W. ErmarthAttachment:
As stated~~SECRET~~

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NIC #03011-88
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CONCUR:

Deputy Director of Central Intelligence

Date

APPROVED:

Director of Central Intelligence

Date

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DCI/C/NIC:FWErmarth:bha(31Aug88)

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Distribution:

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1 - DDCI
1 - SA/DCI
1 - ER
1 - NIO/Econ
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1 - NIC/PO
2 - C/NIC

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NIC 03008-88
1 September 1988

MEMORANDUM FOR: See Distribution

SUBJECT: Sense of the Community Memorandum: Economic Actions
Against Panama

The attached paper represents the views of the Intelligence Community on the effect of Noriega-related court actions and the imposition of IEEPA sanctions against Panama. It concludes that Noriega's overriding concern is his political survival and, as a consequence, he sees the deteriorating economy in terms of how it affects his position. We believe the economy is a threat only to the extent further deterioration might jeopardize payments to the military or provoke Panamanians to take to the streets in violent protest. We judge, however, that neither of these events are likely over the next six months. To some extent the sanctions are afflicting US firms and Noriega's opponents more than the regime or his supporters. Although retaliation against US firms has been used sparingly so far, we believe Noriega would not hesitate to use pressure if it suited his political or economic needs.

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Assistant National Intelligence
Officer for Economics

Attachment:
As stated

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NIC 03008-88
1 September 1988

Sense of the Community Memorandum:

ECONOMIC ACTIONS AGAINST PANAMA

This memorandum was prepared at the request of the National Intelligence Officer for Economics. It was coordinated with representatives of the Central Intelligence Agency, Defense Intelligence Agency, National Security Agency, The Bureau of Intelligence and Research at the Department of State, Army Intelligence, Navy Intelligence, and the Department of the Treasury.

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NIC 03008-88
1 September 1988**Sense of the Community Memorandum: Economic Actions Against Panama**Summary

Although hurt by U.S. court actions and sanctions, the Panamanian economy continues to function, albeit at a sub-par level. We do not expect that the US-imposed measures will directly deepen the crisis during the next six months either for the economy itself or for government finances. General Noriega will have to manage the situation skillfully, however. [redacted]

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The sanctions are probably having a greater impact on US firms and the opponents of Noriega than on his supporters or the regime. Although retaliation against US firms has been minimal so far, we believe Noriega would pressure US firms if it suited his political or financial needs. Noriega's primary consideration remains his political survival. The economy is a problem only to the extent that further deterioration might jeopardize payments to the military or provoke Panamanians to take to the streets in violent protest. We do not believe either of these events is likely over the next six months. Although some protests and work stoppages are probable, we do not believe they will be sufficiently large or violent to threaten Noriega's control. [redacted]

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Economic Problems

1. Panama's economy was in serious trouble well before the Noriega-related court actions and International Economic Emergency Powers Act (IEEPA) sanctions were imposed. Key elements in the economic slide were:

- the loss of confidence in the economy precipitated by the political unrest that began last year,
 - the havoc the key banking sector faced as a result of a severe liquidity squeeze and capital flight,
 - the disruptive general strikes called by the National Civic Crusade, and
 - the subsequent suspension of U.S. economic and military assistance.
- [redacted]

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Effect of Court Actions and Sanctions

2. Although some businesses may be paying under the table, we believe as of mid-July income denied the regime as a direct result of IEEPA sanctions is about \$85-95 million. This total -- about \$10 million from US Government agencies, \$50-60 million from private US firms, and \$26.3 million from canal tolls -- is approximately equivalent to the regime's payroll for two months. In addition, Court actions taken prior to the sanctions froze Panamanian

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Government accounts in the United States totaling \$50.5 million. In all, these actions have reduced monthly government revenues by 25 percent compared to last year, and we expect them to cost the regime as much as \$200 million by yearend. [REDACTED]

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Noriega's Response

3. Taking into account the effects of US actions and the overall decline in economic activity, government revenues now are about 50 percent less than they were at this time last year. Noriega has responded by cutting expenditures, running arrears with suppliers and creditors, and drawing down cash reserves.

- Instead of laying off workers, the regime is cutting remunerations by shortening work hours, forcing employees to take unpaid vacations, and lowering salaries.
- It also has delayed paychecks and other official obligations, and recently announced that it would be unable to pay government workers the \$18 million bonus due in August.
- The regime also is refusing to cash some of the government checks it is issuing in varying denominations for payroll and services, leading to their use as a quasi-currency. They are worth full value in transactions, and have allowed the government to avert the financial collapse that many thought was imminent.
- Even before the US actions, the regime suspended payments to commercial creditors. Including the savings from this and unpaid obligations to official lenders, the government will have withheld over \$550 million in interest and principal payments by yearend.

The lower government income has also caused a suspension of critical public investment, such as in the electric power sector. There are shortages of spare parts and the road system is deteriorating. [REDACTED]

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4. The military -- whose support is vital to Noriega's continued control-- largely has been spared economic pain. Because of their importance and the fact that their wages represent a relatively small share of the government payroll, they have not missed a paycheck, although there have been some delays. The military's position relative to other groups in Panama probably has been enhanced, since their incomes have been maintained. Lucrative illegal business activities also bolster their position. [REDACTED]

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5. Panama's free market and service-orientated economy has made adapting to the revenue crunch easier. Businessmen in the service sector generally have small fixed costs as compared to firms that have large investments in plant and heavy equipment. Wages and rent account for the majority of the costs that companies in the service sector face, so they can adjust relatively quickly to changing economic conditions -- they can close their doors or operate at lower levels of activity with less pain than the owners of large manufacturing plants. Finally, because they do not require large capital outlays to start-up business, these firms will be positioned to expand economic operations when the economy turns around. [REDACTED]

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Impact on Noriega

6. We believe that over the next six months the sanctions and other actions are a manageable problem for Noriega, both in economic and political terms. Indeed, Panama's economic difficulties are afflicting his opponents more than his supporters. As to the overall slide in the economy, Panamanians are deeply concerned about the future and blame Noriega for the downturn but, except for sporadic, small-scale protests, they have not taken to the streets effectively since the sanctions have been in place. The last successful mass protest was the general strike in March. [redacted] many in the private sector -- initially willing to accept an economic sacrifice in return for democracy -- now see themselves losing a war of financial attrition and being forced to fold before Noriega feels the pressure. As a worst case scenario, these businessmen see their country bankrupt and broken beyond recovery to pre-crisis norms with Noriega undaunted and still in place. Calculating that Noriega is here to stay, they want the confrontation between the United States and Noriega to end and are encouraging the opposition to open a dialogue with the regime. [redacted]

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Costs to the United States

7. We believe the costs to US interests imposed by the sanctions may grow. US firms [redacted] complain they have lost markets and competitive advantage to foreign firms that are not bound by the sanctions. Although exemptions have been granted, many still remain at a competitive disadvantage because of the sanctions. Accordingly, we believe US firms will play a smaller role in the inevitable economic reconstruction once the current crisis is resolved. The Taiwanese and Japanese, among others, will move in to fill the void. To date, retaliation against US business interests has been used sparingly. Nevertheless, we do not believe Noriega would hesitate to pressure US firms strongly if it suited his political or financial needs. [redacted]

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8. The economic crisis also is providing opportunities for elements counter to US interests. Local banks are trying to attract deposits and are more willing to ignore regulations because of the financial situation, although money launderers so far have not responded due to the political climate. These traffickers, however, are investing in real estate and capital goods. In addition, the Libyans have extended their influence [redacted] Cuban and Nicaraguan economic advisors, medicine, and fertilizer also have found their way into Panama. [redacted]

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Outlook

9. During the next several months, we believe the regime will muddle through whether sanctions are maintained or not. The Panamanian Government probably can further lower expenditures in stages, first by trimming the more obvious public excesses -- eliminating positions that pay Noriega constituents a salary for no actual work, for example -- then by further delaying payrolls, cutting pay, and, ultimately, selectively laying off workers. The regime has sent the message to public sector workers that significantly lower wages might be necessary to avoid eliminating some 20,000 jobs. Some wildcat strikes or work stoppages may occur, but not sufficiently violent or widespread to threaten the regime. [redacted]

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10. We believe a number of factors contribute to the regime's staying power. These include:

- Noriega's continued ability to shield the military from the effects of the economic crisis.
- The ineffectiveness of the opposition and the unwillingness of most public workers seriously to challenge the regime.
- Panamanians' continued ability to adapt to deteriorating economic conditions, facilitated by their lower expectations and their short-term resignation to Noriega's control and economic decline.
- Financial relief obtained by the government by issuing checks, and obtaining foreign aid assistance.
- The continued inflow of dollars from the Colon Free Zone, private firms, and other sources outside the reach of U.S. sanctions.

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11. We believe Noriega's interest in the economy is limited to how it affects his political survival. He is only concerned about adapting to changing economic conditions, not about implementing badly needed economic reforms. Despite the continued deterioration we predict over the next six months, protests and demonstrations will not unseat him. At the same time, the military is unlikely to miss a paycheck. Given these judgments, we conclude that economic factors alone will not prompt Noriega's departure.

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12. Despite our belief that the Noriega regime can prevail, several factors could alter our outlook. We judge that the following events could challenge the regime's grip on power:

- If the government were to respond to fiscal squeezes by the excessive printing of government checks, the instruments could begin to be discounted heavily, or ultimately even rejected. Continued discipline will be critical for financial survival.
- Also critical to the government check mechanism is the continued willingness of international banks to act as clearinghouses. If revenue shortfalls result in Panama's foreign accounts being depleted, it would be difficult to find an international bank that would do business with the regime.
- Continued support of the regime from union bosses also is critical. So far, labor leaders have been able to soothe most of the rank-and-file. An end to this discipline or a decision by union leaders to adapt a confrontational approach could lead to disruptive public demonstrations.
- A breakdown in the distribution network from suppliers to retailers, would cause shortages and also could put Panamanians in the streets. In a similar vein, many producers have been relying on inventories to

meet demand. Unless they step up production within the next several months, shortages, and associated increases in inflation, are likely.

- Finally, the government's inability to maintain the infrastructure needed to avoid a disruption of canal operations could provoke customers -- and current regime sympathizers -- to pressure Noriega.

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NIC 03008-88
1 September 1988

SUBJECT: Community Paper on the Panamanian Economy

External Distribution:

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